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Foreword

The three essays appearing in this issue have a common theme. Each presents a perspective on the economic redevelopment of Ukraine's industrial sectors. It is proposed that redevelopment occur on a *regional* basis and utilize a *cluster* model of development. Both concepts presented are novel for Ukraine. Yet the application of the concepts, and actions, proposed for Ukraine's economic resurgence in the three articles are *not* novel for industrial States over the globe. Indeed, the *regional development* approach to stimulating economic expansion has been in global progress for several decades. Regional development occurs within natural economic zones and is not confined by Oblast borders. It is common economic interest, and mutual dependency, that forms the basis for united effort.

Similarly, the spread of the cluster pattern of industry sector development, too, has been observed on all continents and in states with economies in varying stages of maturity. Indeed, the formation of industry sector clusters within geographic locations is a well-known pattern. Geographic locations such as Bordeaux, Sheffield, Ruhr, Silicon Valley are economic landmarks. These cluster names have become synonymous with centers of regional craftsmanship and commerce.

Neither of these two patterns of economic development have emerged naturally in the Ukraine State. The three articles presented in this **POLICY STUDIES** publication examine certain behavioral characteristics present in the economic sector, and the body politic, that thwart the *natural* emergence of cluster patterns.

The *first* essay examines two exhibited behavioral characteristics that lurk in souls of those participating most directly in the States economic reformation. The article suggests the prevalence of a type of *apartheid* dividing the entrepreneur and the *chinovnik*. Its presence underlies all those systemic barriers so often cited as obstacles to economic development, and particularly to entrepreneurial activity.

The *second* essay presents a description of the cluster pattern of entrepreneurial behavior. Described are characteristics of the cluster pattern of networking and benefits from such arrangement for participating firms, particularly for small and medium size enterprises[SMEs]. For illustration the article presents the experience of the Podillya Pershyi NGO

in its application of the industry sector cluster strategy for the regional economic redevelopment of Podillya.

The *third* essay examines the NGO structure as an institutional entity through which the regional redevelopment program and implementation process takes place. Here, too, is cited the experience of the Podillya Pershyi NGO in its formulation of the regional economic redevelopment program.

The economic concepts presented in the three essays are deemed vital to the course of restoration of Ukraine's economy. Valuable years have passed in frustration. Invested resources have, too often, yielded only marginal benefits. And now the State proposes to embark on a yet new Decree for "economic stabilization and stimulation." The articles suggest that any future State economic initiatives would benefit from embodying the twin concepts of regional redevelopment and industry sector cluster development.

Wolfgang PRICE,

Economist, advisor to the Khmelnytskyi Oblast State Administration

Human Behavior: A Factor in Applied Economics

Wolfgang PRICE, economist, advisor to the Khmelnytskyi Oblast State Administration

This article proposes Regional Government initiatives for economic reform should proceed with more determination. In Ukraine the government servant and the entrepreneur confront each other in an economic, social and political arena. The schism needs healing, as the common interest of the body politic in a vital economy must again come to prevail. Everyday contacts between the Oblast official and the entrepreneur imply mutual favors and redress. It is here that the opportunity for dialogue on reforms is most promising. At the same time, a sort of anarchism evolved within the ranks of entrepreneurs, as each business proprietor is preoccupied with his business self-interest. In fact, the "business community" is not a community. Rather it functions as a series of feudal business fiefes, each entrepreneur isolated, securing his private business interests against incursions both by the State and other companies. The cluster pattern of the industrial firms' behavior is a means for reunifying the now divisive distrust that pervades Ukraine's business scene and begins the transformation toward a business community.

Ukraine is in the midst of an economic crisis. Industrial output in most industry sectors is in decline, especially in the important medium-size business sector. Explanations for the deteriorating conditions have been documented in various journals and so need not be repeated. It is important only to note here that, generally, the explanations place the causes on the actions, or inaction, on the Central Government. It is deemed a crisis stemming from a lack of political resolve to face the political consequences from drastic economic reforms.

This article suggests that economic recovery requires reforms at both the Central Government and the Regional Government levels. Indeed, it is a grave economic, as well as political, error to defer aggressive economic reforms at the Oblast level in anticipation that a National Economic Policy will emerge at the Central Government level.

This article proposes *Regional Government initiatives* for economic reform should proceed with more determination. Regional economic actions are often more immediate, and decisive, in fostering economic development at the local level

than the present anticipated actions by the central regime. This article further proposes that *economic reforms* that originate at the regional level, and so reflect local economic conditions, are often more consequential than the national initiatives of the Central regime. Indeed, regional administrations that exhibit effective leadership can, when cooperating with the business community, be an impetus in advancing Central Government economic reforms for fostering economic and business development.

What then are those economic, and political, actions that can be initiated at the Regional Government level to create a more potent economic environment? It is proposed that those actions are of two types:

- Actions that entail *attitudinal* and *relational* readjustments.
- Actions that entail *realignment* and *reorganization* of regional industry sectors.

Attitudinal and Relational Adjustments

The enduring Ukraine soul nurtures an ambivalence toward the respective functions of the public and private sector economic activity. Under the former regime economic and political action rarely could be differentiated. The operation of the economy was a Government function. The economy was perceived as an activity to further the aims of a State socio-political ideology [in contrast to a private, market-based economic ideology]. The plant director may not have been pleased with Central Government directives but he (she) seldom disowned his (her) position in the functioning of a State directed economy. Ever, the factory director remained, foremost, a State Government *civil servant*. One civil servant may have directed activities in an Oblast administration, while another civil servant directed the activities in a factory, *but both directors were parts of a common soul*.

The progressive dissolution of the former regime has engendered schisms...both in reason and in ideology. Ukraine has lumbered down the fearsome road to privatization of its industry and the bewildering road to a competitive market economy. The earliest manifestations in this hasty, "overnight", transition is the appearance of an *avant garde* [imitation western style] managerial elite. The newly styled "business" director [*entrepreneur*] has shed his former affiliation as *civil servant*. He now faces his former counterpart

[*Tovarisch*] in the Central Government and proclaims for himself: I represent the new order and, as such, now shoulder economic interests that are not only different [from those of the Bureau Director] but are even superior to the bureaucratic [and nonproductive] pursuits of the State. No longer are they brothers, or soul mates. Those directors who now determine the course of economic activity in the public and private sectors have become the off-spring of Cain and Abel.

Lest there be a doubt let one witness the private sentiments of the body politic when engaged in discussions on the merits of Ukraine's new Entrepreneur class.

How many would rate the attributes of the business profession as among the most desirable? Businessmen among the most revered? And place business success among the notable personal achievements? What impression lingers in the soul of the body politic when considering accumulated personal business wealth? Is one likely to hear compliments for such achievement? Is one likely to find one likely to encounter helping hands on the road toward business achievement? Inviting business associates? In brief, would one characterize the abiding disposition toward business as worthy of endeavor for one's own youths? [These among the most valuable resource of the nation.]

Let us turn now to those who presume to lead the nation, the States *nomenclature*. How would the body politic characterize their efforts? Their progress? Their leadership? What ideals are these deemed to imbue in their charges? Would their minion select from among these their *nomenclature* those who best symbolize vision for the State's economic prosperity? Is Government service deemed among the most respected of professions in this the States most trying hour? Is service in the State's Tax Department hailed for its vital role in sustaining the State? Its Officials *heralds* during a ruinous and demoralizing period of economic crisis? Is professional service in the State's Inspection Departments deemed exemplary? Or, so, service in the State's Certification Departments? Is it a common belief that the *nomenclature* in public service serve their State with more purpose than so the entrepreneur in

"The negative psychological attitude of the population towards entrepreneurs was cited as a "characteristic feature of the current state of the SMEs sector in Ukraine". Barriers to the Development of SMEs in Ukraine, 1998, Kiev Management Konsult.

private service? That the former serves with more integrity than the latter?

Which queue would one find the preferred: that of unemployed applying for open positions in the State's bureaus or that of those applying for open positions in the private sector's commercial establishments? From which lineage rise the nation's heroes?

It is a divisible soul that lurks in the Nation's striving for a gratifying economic future.

And what is the harm? The harm resides in the erosion [devolution] of the community common interest in a vital economy. The tax-collector, and the tax-payer, confront each other in an economic, social and political arena². There fades the perception of a joint, and common, interest among the Directors in public and private sector economic endeavors. Instead there languishes an economy amidst internal antagonism. So alienated the legions on both sides engage each other while witnessing the Nation's economic stagnation.

And the remediation? The restoration of a body politic in which the public and private sectors *cease to endure the harm to their society from their opposing interests*. There must come to prevail a therapy that induces both the public official and private sector manager seek to harmonize their institutional prerogatives *through progressive toleration, cooperation and collaboration* in behalf of the society interest in a vital economy. The schism needs healing. The common interest of the body politic in a vital economy must again come to prevail.

It is proposed that this mending process can best proceed at the regional level. Entrepreneur contacts with Oblast Chinnovnik are commonplace. The Oblast official and the entrepreneur interact in the conduct of their formal regulatory and business affairs in the region. In these contacts there are opportunities for favors and redress. It is here that the opportunity for dialogue on reforms is most promising.

Recently the desirability of *regularizing contacts* for more general discussion of economic issues has received consideration both by the Khmelnytskyi Oblast and the Khmelnytskyi City

² It is not suggested that in the peaceable kingdom the tax collector will appear the lamb. The state will always extract it due. But in the present relations there appears provocation: the Official's behavior resorting to autocratic administration; the Entrepreneur's behavior resorting to deceptive manipulations.

Administrations. The City Administration convened a Conference in January 1999 at which businessmen, associations and tax officials presented "statements" on their respective perceptions of prevailing exacerbating business conditions³. Entrepreneurs were afforded the opportunity to present their views on certain questions. Officials stated that a new Office would be created within the City Administration to address issues affecting Government – Business relations⁴. It is intended that other City actions will follow an assessment of the conference and the responses. Yet in some there lingers insincerity over the City's abrupt demonstration of welfare for the Entrepreneur and for business interests. The Administration's financial distress is acute. Taxes, fines, fees and permits are its *trade* and the *legal* entrepreneur its market⁵. The registered entrepreneur feels the sting of the tax collector's disrespect with regularity⁶. Those operating in the *shadow economy* seem, more so, spared from official interference. So it remains to be seen whether the intentions are genuine and the

³ *Conference on Questions of Entrepreneurship Development in Khmelnitkiy: Problems and Prospects*. At the conference City Officials stated that information was desired on matters that would enable the work of local government to be more compatible with the needs and desires [wishes] of entrepreneurs. Participants were requested to respond to such questions as: (1) What was the motivation to start entrepreneur activity? (2) What were believed the main reasons stifling the development of Entrepreneurship? (3) What are the main factors believed to influence the development of Entrepreneurship? (4) What measures were believed to be the most effective in the development of SMEs?

⁴ The City Administration has completed its evaluation of the responses and is proceeding with creation of Department of Entrepreneur Relations.

⁵ In Khmelnitskiy there is a vast *shadow economy* that operates on the fringes of government regulation. The local "regulations" that apply to this sector seem more informal. Here the tax and inspection authorities are seldom evident nor was there interest in improved City Administration relations presented.

⁶ For instance, one sees in the bazaars seldom the disregard of the vendor that the Author witnessed in a local café. While at the counter ordering a meal a man forced his way to the cash register and demanded from the attendant that an immediate balance be made of the sums. Compliance required that all cash be displayed on the counter and that all bills and coins be staked. Satisfying the inspector took nearly thirty minutes. During this interval no service could be provided to customers. Such random inspections can occur several times a week and, usually, during the busiest period.

results meaningful. Clearly the harmful conditions that prevail do deserve local government attention.

Clearly there are economic reforms that can only be addressed effectively by the Central Government. (However, care should be exercised that in vaunted reforms no new barriers to economic revitalization are introduced in the course of Central Government expediency to address national economic insolvency.) Regional administrations should not be idle in the interim. There are opportunities for Regional reforms that would ease the development of SMEs and entrepreneurship. The most significant among these regional reforms is the propagation of a harmonizing business environment, one based on the principle of mutual regard for civil institutions and private enterprises. Moreover, leaders from both sectors should join in a common commitment to elevate integrity in the conduct of commercial activity. The reconciliation of the Ukraine soul, and can not, must not, await a messenger from Kyiv.

Organization of Regional Industry Sectors

Here, as well, the Ukraine soul nurtures a schism. The fracture is even more insidious in its harm than the public-private sector alienation. The breach is, in essence, a sort of [anarchism] within the ranks of the land's entrepreneurs. Each business proprietor [irrespective of the business ownership structure] is preoccupied, often obsessed, with his [her] business self-interest. By inclination the "business community" *is not a community*. Rather it functions as a series of feudal business fiefes, each entrepreneur isolated, securing his private business interests against incursions both by the State, and other companies⁷. In this struggle all types of companies, both within an industry sector and among other sectors, are deemed arch *rivals*, either in their products, markets or in their requirements for capital⁸.

⁷This pattern of behavior contrasts with the Ukraine historical traditions of *cekh*. Once the concept of *cekh* embodied the behavior of cooperation and collaboration among craftsmen and tradesmen in pursuit of their economic interests. In its origins the concept is a predecessor form of the modern-day industry sector cluster.

⁸ This behavior pattern has been noted one of the characteristic features of current conditions in the SME sector in Ukraine. *Barriers to the Development of SMEs in Ukraine, 1998, Kiev Management Konsult.*

One can, of course, identify certain nascent efforts to assemble business owners by forming entrepreneur "associations". Several of such *associations* have large memberships⁹. Regional associations also proliferate¹⁰. As such these associations increasingly are a political force through their vocal petitions to the Central Government to consider grievances, amend business regulatory constraints or revise economic policy. [Regional Administrations, so far, seem more spared such concerted appeals from associations.] It is now difficult to foresee the ultimate function of these associations. At present such associations assume, more so, a "fraternal union" than an "economic partnership". Consequently their impact on business operations, business performance and business competitiveness yet remains minimal.

Among the most visible regional associations are regional Chambers of Commerce. Often these engage in active programs for the promotion and trade of products produced in their regions. For instance, in Khmelnytskyi there are eight such exhibitions scheduled, each emphasizing product from a particular industry sector. These resemble "trade fairs". Some such exhibitions have had as many as 75 participating enterprises. Their aim seems, primarily, one of product exposure. The participants are linked to the association, *not to one another*. Among these there is no sense of union [*oseredok*]. No common business purpose *bonds* them for their mutual economic welfare. No *berucksichtigen* exists. The exhibition ended and each entrepreneur resumes his/her singular quest [*ordeal*] for survival. As such these types of associations offer members some modest relief and distraction from the daily preoccupation with cash flow¹¹, shortages and regulations.

⁹ Examples of such national associations include Association of Ukraine Cities; Ukraine Producers and Consumer League; International Food Products Producer Association; Ukrainian Union of Industrialists and Entrepreneurs; Ukrainian Entrepreneurs Union of Small, Medium and Privatized Enterprises.

¹⁰ Examples of such regional associations are: Association Khmelnytskyi Regional OBLAGROTECHSERVICE; Khmelnytskyi Union of Industrial Producers and Entrepreneurs.

¹¹ Cash-flow is a particularly vexing problem for the Entrepreneur, particularly for the enterprise engaged in Government contract work. The failure [abuse] to pay promptly for goods delivered creates for the enterprise crises in liquidity. The replacement of

The formation of industry associations has also spread to enterprises that operate in closely related industry sectors [e.g., dairy products, and meat products]. Within these sector associations there is an increasing readiness to communicate on product, as well as business, related matters. Progress in business development within these sector associations is often advanced by the availability of specialized assistance from several foreign economic aid programs. For instance, VOCA has become increasingly active in assisting SMEs within associations that specialize in agricultural products¹². These types of programs enable the entrepreneurs to *listen* to one-another, if not yet accept more binding forms of cooperation and collaboration. Advancement of enterprises in these associations toward higher stages of bonding, e.g., mutual dependence, remains to be realized.

What then is a *cluster*? Is it a new mode of economic structure? And what makes it relevant for Ukraine? *Clusters are geographic concentrations of interconnected enterprises and institutions within a particular industry sector*¹³.

Industrial, or commercial, *clusters* are evolved economic networks within which vital economic elements are nurtured: (a) increasing productivity; (b) stimulating innovation; (c) stimulating competition; (d) fostering new business formation. A *cluster* is thus an amalgam of enterprises and institutions that *interact* to allow the individual member firms to realize benefits that are larger than could be gained from operations in isolation. Clusters enable firms to respond more flexibly to volatile/uncertain business condition while maintaining the benefits from product specialization. As such the *cluster* mode is the antithesis of industrial and commercial structures common in present-day Ukraine.

barter goods for cash often exacerbates the serious condition. Taxes, for instance, cannot be paid in barter goods.

¹² In the Khmelnytskyi region The Alliance for Collaboration on Enterprise Development ACDI/VOCA, Kyiv Office, has conducted factory consultations and group presentations for enterprises during which food processing techniques were presented and discussed among the participants.

¹³ The statement is slightly modified from definition by Michael E. Porter, "Clusters and the New Economics of Competition", Harvard Business Review, December 1998. Various portions of this section are attributable to this author. Porter adds: "Clusters encompass an array of linked industries and other entities important for competition."

Here, as well, is manifest a sort of schism. Under the predecessor State the industrial development pattern fostered a dispersion of related industry. Supply chains were purposely fragmented. Customers and markets, too, were segmented. Regional centers for specialized products did not develop. [Manufacture of specialized components emerged but these enterprises, too, were isolated and distant from the final assembly location.] And even for those products that have come to enjoy a strong market presence, e.g., Svitoch Chocolate, no prominent regional confectionery industry sector has emerged.

Yet under the predecessor State there emerged in certain sectors a form of industrial development that had the earmarkings of the *vertical cluster* pattern. Large cooperatives then dominated regional output in agriculture products. These massive enterprises were in reality a "cluster" of numerous smaller enterprises producing an array of related farm products. [As industrial structures these conglomerates bore little resemblance to the prevailing "cluster" patterns.] Later when such conglomerates were dismembered by the State a singular opportunity for forming genuine clusters of SMEs went unnoticed.

The evolution of the cluster pattern has a lengthy history. Its merits rest in its *natural* emergence. With an increasing awareness of the economic benefits that the cluster pattern of development affords [and the documented investigation of the cluster phenomenon] attempts at "cloning" the concept have appeared. The early attempts at duplication took the form of expanding already existing concentrations of interrelated firms in regional location. Often this replication was associated with commencement of a "regional economic redevelopment" program. Later the pattern's promise came to be manifest in ambitious undertakings to create a cluster virtually *de novo* using as a nucleus some singular institution or natural resource as the core¹⁴.

¹⁴ The development of the latex glove industry in Thailand is such an example. The ready availability of the basic material combined with a ready labor force that could be trained and a suitable commercial infrastructure served to center this industry sector in the region. An even more ambitious effort at clustering is the "Malaysia 20/20" development. In this instance it is proposed to situate in Malaysia the foremost information technology complex in the world. The region selected affords several infrastructure advantages that constitute the core of the cluster.

Ukraine's future industrial resurgence, in large measure, depends on the regional aggregation of remnant industry sectors into clusters and fortifying their evolution. For instance, in the Podillya region there existed, once, an extensive light industry complex. Not only garments but also textile mills operated in the region. It is estimated that over one hundred separate plants provided over 10,000 jobs. Now about thirty survive, most operating on the verge of closure. Some subsist from the availability to offer "cheap labor" to complete production of garments for foreign firms¹⁵. In so doing these firms are exhausting their once skilled labor [as well as their vintage equipment]¹⁶. A few enterprises have attempted to compete with the flood of foreign imports in the region's Bazaar. Yet here neither price, nor quality, affords the region's producers an advantage. Facing the doom of their industry there has, nonetheless, been no natural resort to unify for survival and secure the mutual benefits from a pact of cooperation and collaboration¹⁷.

The relevance for Ukraine of the cluster pattern of development is evident. Clusters use capital more efficiently and more effectively. Investment capital in Ukraine is scarce, and working capital is costly. Conditions for the effective use of capital must be prepared¹⁸. Clusters enable enterprises to husband their existing resources and leverage any capital infusion. These are vital benefits for Ukraine's capital-starved SME enterprises.

Clusters prompt specialization with the attendant increases in product output and quality. [Among the garment enterprises

¹⁵ Offering cheap labor for exploitation is the antithesis of the aims of the cluster mode of economic development. Clusters advance their competitiveness through practices that yield higher value added output. For industry sector clusters "cheap labor" is not the determining factor for competitiveness.

¹⁶ In some instances the foreign contractor will furnish more modern equipment to increase output or maintain quality.

¹⁷ Likely such inclination to "unifying" in response to threat is thwarted by the varying legal structures of the enterprises in the region. Moreover several of the stronger garment firms in the region are disinclined to ally themselves with the "old" [unreformed] enterprises.

¹⁸ The importance of this matter has been noted in an article by Makhmudov A.G., President, Dikom Invest Company. The article states: Current "...practices indicate that working enterprises are not fully prepared to utilize...investments. Though the majority of Managers...are not fully aware of that (sic)..."

in Podillya there is virtually no product specialization. Each firm hastily produces whatever goods may, momentarily, generate revenue.]

Cluster firms exhibit a tendency to segment the market. This broadens product variety and so spurs business formation. This tendency is amplified by the prevalence of SMEs in the cluster which, by virtue of their size, are flexible and which cumulatively contribute to product variety and market expansion.

Clusters proliferate competition and so spur product innovation by the enterprise as its means of holding market share through product differentiation. Competition also spurs marketing innovations by the enterprise as it seeks to secure brand preferences. For instance, among the garment firms in the Podillya region there is virtually no fashion innovation. Output resembles the styles and patterns that predominated under the former regime. Only four or five SME enterprises in the region, all newly established, have advanced their value-added output with fresh fashion lines and superior craftsmanship¹⁹.

In clusters excess production capacity is minimized. Cost sharing is achieved. The productivity advantages of the "learning curve" are shared. A skilled labor supply is preserved within the cluster of firms in the industry sector. New business formation is enhanced²⁰. [And new enterprises

¹⁹ The variation in response is not a matter of either the availability of capital or technology, although some directors of moribund firms would be inclined to cite this as explanation [excuse] for their distress. Observation of garment cluster behavior clearly indicates that certain directors are more open to innovation and more prepared to assume associated risk. Indeed, in the course of operations of the garment cluster several directors from marginal firms were offered the opportunity to meet with fashion houses in Lodz, Poland, and conduct extensive discussions with the staff of the Polish Chamber of Fashions. To date there is no evidence that this singular opportunity sparked some attempt at product innovation. Indeed, in one or two instances the Lodz experience prompted more intensive *excuses* from factory directors for the inability to produce a more desirable fashion product.

²⁰ The Presidential Decree No. 574/98 "On Measures for Economic Stabilization and Production Stimulation" is said to "state the need to work out a large-scale economic policy of a new kind". Four initiatives are presented in the Decree for resolving the current crisis. The third of these initiatives is said to "attempt to stimulate the development small entrepreneurial activity...by introducing

are viewed as *allies* to the cluster and not as a rivals.] *These advantages represent an indigenous investment capital.* Only, as productivity increases among the enterprises in the cluster do the prospects for investment capital from external sources escalate.

These developmental characteristics are retarded where enterprises [SMEs] work in isolation. Moreover, capital infusion, equipment modernization or technical assistance (TA) *per se* are insufficient offsets to the loss of benefits from forgoing participation in a mature functioning cluster. It is the behavioral economics of *cluster cultures* that must be mastered by the entrepreneur for the survival of regional commerce and, ultimately, the Ukraine economy itself.

The Podillya Pershyi regional economic development program is an attempt to reverse the pattern of enterprise isolation. It fosters, rather, assembly of entrepreneurs and prompts their deliberation on *core business matters*. In the garment cluster, for instance, participating firms are prompted to deliberate such matters as: how the group, collectively, can respond to the to the competition from foreign imports in the Podillya region. Or, whether there are potentially finished, competitive, product that participating cluster firms can bring to the stage of market evaluation? The Program's technical assistance [TA] resources fortify the self-help practices from such inter-firm cooperation and collaboration. For instance, TA resources may provide market evaluation services to the cluster²¹. However management, or government, tech-

authorized entrepreneurial affairs posts, and by creating a net of regional development agencies..." Commentary Vadym Koshchii, Intel News Business Journal, Dec. 11, 1998. The creation of these additional support structures do not *per se* alter the basic conditions that create the crisis in economic performance and lagging SME development. Creation of "institutional structures" are *per se* not economic strategies. The proposed structures may *assist* in implementing national strategies but the intended strategies unstated. The Podillya Pershyi NGO is a "regional development agency" but that in itself does **not** define its strategy for economic revitalization of the Podillya region. It is the NGO's implementation of the *cluster model* for structuring the development of industry sectors and proliferating SME formation that presents a distinct strategy for economic revitalization.

²¹ Past efforts to support with foreign aid various forms of technical assistance [TA] for Ukraine industrial and commercial development have only been marginally successful. It has scattered the land with "business centers", "business incubators" and all sorts of specialized

nical assistance providers *do not lead* the process of development, rather TA providers *follow the lead* of the entrepreneurs as these, the Captains of Commerce, seek through their own business deliberations to reach a commitment on some form of business activity²². Technical assistance resources cannot replace entrepreneurial product innovation and commitments among businessmen to pursue ambitious ventures. Nor can seminars on entrepreneurial issues replace the keystone practice of continuous entrepreneur networking. TA resources for support should be available but must not displace basic entrepreneurial activities. The work of revitalizing an industry sector must be commenced by the businessmen within the sector cluster. Only genuine, joint, attempts at improving competitiveness and productivity through mutually deliberated business arrangements will yield the required conditions in which TA can *compliment* cluster firm arrangements and commitments to pursue business interests.

The apparel industry cluster is in its infancy. Initial efforts have been devoted toward improving fashion designs; mastering quality requirements; determining product specialization; and, creating product and company identity through trade names and trademarks. The development in Podillya of "cluster form" of relations among the participating firms is on the verge of the *cooperation* stage. There yet lingers the tendency to withdraw into solitary business activity. It is anticipated that the introduction of several new types of fashions by firms in the cluster will further serve to weld the common interests of the garment manufacturers in Podillya and reestablish it as an important textile and clothing-making region. The prospect of creating a regional "fashion center" for Podillya is one unifying condition. So is also the prospect of a kiosk in the Bazaar to market competitive products from cluster producers that are, now, marketed on a consignment basis through other vendors. Such efforts will require sup-

business and product assistance services. Countless "business plans" have been prepared. Numerous management training programs have been offered. Nearly all these services are presented in settings that foster isolation...even when the participants are in groups for the TA event. Sometimes the participant entrepreneurs in groups even express their views vigorously. But this form of activity is basically not cooperative nor collaborative behavior.

²² A State economic policy of introducing "authorized entrepreneurial affairs posts" orients the central function of business creation to the *Chinovnik*. It is the entrepreneur who must become more proactive in the performance economic activities, not the *chinovnik*.

port but such TA can, now, be leveraged from a much higher level of producer potency.

The cluster culture is one that unifies enterprise efforts to be competitive. It unleashes the pent up business acumen among individual entrepreneurs and affords opportunity for synergy. The cluster generates its own capital, the essential *know-how* for remaining viable. As such cluster behavior holds the prospect for reunifying the now divisive distrust that pervades the Ukraine business scene and begins the transformation toward a business *community*.

Clusters and Their Role in the Resurgence of the Podillya Economy

Evhen BEZVUSHKO, Podillya Pershyi NGO

If one turns to the history of developed countries, he would find that a government facing economic crisis played a key role in developing regional “autonomous mechanisms” and stimulating private business at the local level. One would also notice that the most effective programs turned out to be those which envisioned creating regional industry sector clusters. The regional industry cluster pattern is universal for any industrial sector in any region. It helps develop industries in a particular region while considering its individual features. Industrial clusters stimulate competition, foster innovation, and increase productivity in all economic sectors. The program for creating industrial clusters in the Khmelnytskyi Oblast, which is implemented by the Podillya Pershyi NGO, aims at restoring economic vitality and developing backgrounds for a viable economic community in the Podillya region.

What Is a Cluster?

Clusters are geographic concentrations of interconnected enterprises and institutions within a particular industrial sector. Clusters enhance competition through (1) increasing productivity, (2) stimulating innovation, and (3) forming new businesses.

Clusters are geographic concentrations of interconnected enterprises and institutions within a particular industrial sector. A cluster allows each member to benefit as if it had a greater scale or as if it had joined with others formally, without requiring a sacrifice in flexibility. Thus, the competitive advantage rests on making more productive use of inputs, which requires continual innovation.

Clusters encompass an array of linked industries and other entities important for competition, such as universities, standard-setting agencies, think tanks, and trade associations which provide specialized training, education, information, research, and technical support.

Clusters represent a new way of thinking about a location, challenging much of the conventional wisdom about how companies should be configured, how universities can contribute to competitive success, and how governments can promote economic development and prosperity.

Clusters have positive implications for both individual enterprises and the regional economy in general. According to Michael Porter²³, expert on the cluster model, clusters enhance competition in three broad ways:

1. THEY INCREASE THE PRODUCTIVITY OF COMPANIES BASED IN THE AREA. This occurs due to (a) better access to employees and suppliers, (b) access to specialized information, (c) complementarities, (d) access to institutions and public goods, and (e) better motivation and measurement.

2. THEY DRIVE THE DIRECTION AND PACE OF INNOVATION, WHICH UNDERPINS FUTURE PRODUCTIVITY GROWTH. This may result from (a) better window on market, (b) capacity and flexibility to act rapidly, (c) experiment at low costs, and (d) competitive pressure, peer pressure, and constant comparison.

3. THEY STIMULATE THE FORMATION OF NEW BUSINESSES, WHICH EXPANDS AND STRENGTHENS THE CLUSTER ITSELF. This comes from the fact that (a) individuals more easily perceive gaps in products and services, (b) needed assets, skills, inputs and staff are readily available for new enterprises, and (c) formation of new business becomes a part of a positive feedback loop.

To conclude, a cluster allows fast improvements in the production process, formation of new small- and medium-sized businesses, and successful competitiveness of domestic firms in both the internal and foreign markets.

Economic Preconditions for Creating Industry Clusters in the Khmelnytskiy Oblast

Until 1990, the Khmelnytskiy Oblast, as the biggest economic entity in Podillya, had been specializing in textile and apparel production for domestic consumption. About 35-40 garment and textile-making enterprises have survived, most operating on the verge of closure. They have lost their share on the market as a result of the inability to reorganize their activities and adjust to the new economic environment. They also failed to compete with import products due to an absence of product innovation. In order to survive, many firms began

Until 1990, Podillya had been specializing in textile and apparel production. The output in this sector resembles the styles and patterns that predominated under the former Soviet regime: enterprises do not have any product specialization and do not formulate any adequate idea regarding competition, but they employ highly skilled workers. As a result, the textile and apparel industry cluster has been created in the region.

²³ "Clusters and the New Economics of Competition", Harvard Business Review, Nov.-Dec. 1998

working by tolling schemes to export their end products back to foreign partner firms. This would allow them to receive marginal profits, but it eliminates any chance to develop production.

Today, the garment and textile output in the Oblast resembles the styles and patterns that predominated under the former Soviet regime: enterprises have virtually no product specialization and do not formulate any adequate ideas regarding competition. All newly established firms are oriented toward the domestic consumer, but the Oblast market is congested with cheap imported goods. At the same time, local textile mills cannot successfully respond to the competition from foreign products of higher quality, as their access to better textiles and technologies is limited. As a result, local firms fail to make fashionable and high-quality products.

At the same time, the firms employ highly skilled specialists who are capable of crafting modern and qualitative goods. In addition, the Oblast educational institutions (in particular, the Technological University of Podillya) foster a new generation of designers, constructors, and craft engineers. This considerable labor capacity of the regional garment industry proves professional in dealing with any problem at hand.

Analysis of the Oblast garment and textile industry shows that its resurgence is possible under the following conditions:

- Textile and garment firms form clusters and begin to collaborate, aiming at entering new markets.
- They produce models which can create demand for them.
- Advantages are gained from cooperative efforts in arranging supply and sales networks, as well as implementing the principle of product specialization.

The consequent outcome of the NGO's activities was an association of 24 apparel and textile enterprises with different forms of ownership in the regional industry cluster.

Podillya Pershyi Program

Performance of the textile and apparel cluster proved that implementing the cluster pattern significantly increases effectiveness of business activities. Therefore, entrepreneurs from other industrial sectors, in particular, the food processing industry and construction materials, took to the idea of the

As soon as entrepreneurs from other industrial sectors took to the idea of the cluster entity, the Podillya Pershyi Program was developed. This is a program aimed toward economic redevelopment of the Khmelniitskiy Oblast, which envisions (1) implementing the cluster strategy, (2) developing new business linkages that would allow enterprises to gain maximum capacity, (3) utilizing idle natural and labor resources.

cluster entity. As a result, the Podillya Pershyi Program has been developed.

The Podillya Pershyi Program is aimed toward economic redevelopment of the Khmelnytskyi Oblast, which envisions (1) implementing the cluster strategy, (2) developing new business linkages that would allow enterprises to gain maximum capacity, (3) utilizing idle natural and labor resources. It strives to improve and expand all industries which may influence the development of the Oblast economy.

The Podillya Pershyi Program relies entirely upon public initiative. It is independent of anybody's financial support. Economists, top managers of enterprises, financial experts and local executives developed and implemented the program on a voluntary basis.

The program assists in eliminating negative attitudes that exist between government workers and businessmen. The latter realized the effectiveness of local initiatives in their struggle to improve the business climate. Regular meetings between enterprises and associations into clusters have favored their joint attempts in conducting local business.

As was stated above, the Podillya Pershyi Program considers employment of idle natural and labor resources one of the most effective measures for economic redevelopment. The most valuable resource of the Oblast is youth. The Program continuously collaborates with the Technological University of Podillya. For instance, students from the University are enlisted to assist in redesigning and re-styling fashion apparel produced by cluster enterprises. Many of them are involved in developing new trademarks or compiling requirements from the Internet for textiles and labels which will be considered for entering foreign markets. A group of students creates Web pages for easier access to information about Program activities. In addition, the Podillya Pershyi Program shares its organizational work with volunteers from the University.

Program goals are the following:

- Enhance economic activities in Podillya by stimulating private entrepreneurship in three major local industries: (a) garment and textile production, (b) food processing, and (c) construction materials.
- Improve competitiveness in the mentioned sectors and assist in forming new businesses.

- Turn Podillya into a region of world-known craftsmanship.

Based on these quite ambitious goals, experts developed a strategy for implementing them:

- Mobilize public and private resources to support the NGO that implements the Podillya Pershyi Program.
- Utilize resources from the SME-UNIDO program²⁴ in order to create a cluster which is viewed as an effective means for magnifying productiveness and competitiveness of small- and medium-sized enterprises in the Oblast.
- Use technical expertise from donor countries to test innovations, which will favor competitiveness of the firms in the Oblast.
- Conduct negotiations with international financial organizations on investing in the Khmelnytskyi Oblast economy.

In addition, the NGO which implements strategic goals of the Program has created a network of useful links with various organizations and companies that contribute in cluster development. These are the following:

- Khmelnytskyi branch of the State Innovation Fund of Ukraine, which assists in innovation activities of small- and medium-sized enterprises. The director of the branch is a member of the Executive Committee of the Podillya Pershyi NGO. The NGO has been also conducting negotiations with the Fund on (a) concluding a contract to supply enterprises with information, and (b) investing in the project for innovations in garment production.
- UNIDO, which is involved in negotiations on an official contract for supervising the clusters. This could facilitate implementing the cluster concept in other industries of the region. UNIDO will also assist in finding donor countries willing to finance product innovation in the garment industry.
- Oblast financial institutions: a number of banks in the Oblast participate in the Program. Thus, the garment industry cluster collaborates with (a) a representative from "Prominvestbank"; (b) Director of the Khmelnytskyi

²⁴ The program for supporting small- and medium-sized enterprises developed by the United Nations Industrial Development Organization.

branch of Ukrsofsbank, who provides services to the Executive Committee and its members; (c) Head of the NBU's representative office in the Khmelnytskyi Oblast, who presents the National Bank of Ukraine in the Executive Committee of the NGO.

- Potential wholesalers for the apparel produced in the cluster enterprises. Thus, Volodya Plus Firm, which owns a retail chain throughout Ukraine, agreed to include cluster-produced models in its fashion collections.

The aggregate effect of these links stimulates enterprises to join clusters, which results from the following advantages:

- Easier access to experts.
- Easier access to information on material resources, wholesalers, standards, export requirements, etc.
- Access to investment funds for improving productivity and competitiveness.
- Cooperative purchases and sales (for example, the cooperative purchase of textiles means a larger variety of textiles and lower prices on greater volumes).
- Access to legal aid on registering procedures envisioned for trademarks.
- Participation by entrepreneurs in business trips to foreign countries for learning more specifics in their business.

Currently, 24 enterprises of the textile and apparel industry cluster benefit from these advantages. More than seven firms applied for participation in the program.

Outcomes

The first six months of the Program have turned out to be very productive. The first cluster to join enterprises of the textile and apparel industries has been established, receiving regular financing and technical assistance.

At first, representatives of the Oblast State Administration were skeptical about the activities in the Podillya Pershyi Program, but soon after they appreciated its effectiveness in forming business in the Oblast. Furthermore, the program helped the Oblast State Administration and the Executive Committee of the Podillya Pershyi NGO prove that the Khmelnytskyi Oblast is favorable for implementing the World

The first cluster already exists, with regular financing and technical assistance. It also receives support from the regional authorities and the World Bank. This anticipates resurgence of the Podillya economic sector.

Regional industry sector clusters

Bank's private sector development program, which was developed for three winning Oblasts of Ukraine.

So far, the cluster concept has been novel for Ukraine, though it is a well-known pattern of industry sector development in advanced economies. The Podillya Pershyi Program, which stimulates industrial clustering of Podillya enterprises, aims at arresting economic recession in the region. The outcome of the Program is resurgence of currently operating companies, organization of new firms, creation of new jobs for skilled workers, and production of goods with high added value. This strategy will undoubtedly transfer economic stagnation into growth.

Role of the Non-Government Organization as "Change Agent"

"...the third leg of our global community..."

Hillary Rodham Clinton

Wolfgang PRICE, economist, advisor to the Khmelnytskyi Oblast State Administration

Even in advanced economies the relations between government regulatory authorities and associations of private business leaders are not without strains and awkward accommodations. Mitigating excesses in the public and private sectors are the presence of a multitude of aligned and unaligned organizations and associations that monitor the rules and practices and intervene in the conduct of the economy. Such institutions, recently transplanted on the Ukraine soil, are the saplings of legal entities now common to the North American continent: the not-for-profit (non-government) organizations. They may be viewed as the vital linkage among networks of business, government and community leaders. These networks are based on voluntary commitments to shared interests. NGO intervention in the organization of industry sector clusters has the potential for reconciling the mistrust that commonly exists among competing firms.

The opening essay noted present in the economy, and civil society, a polarization of the public and private sectors and cited [indicted] the breach [rupture] as a fundamental behavioral distortion in present attempts to restore the Ukraine economy. Moreover, the festering alienation has eroded the ethical transformation of the society. Cited is a combination of State, and industry, failures born out of bedevilment and mutual distrust, that have come to characterize the prevailing economic decay.

The essay also cited the present segmentation of enterprises within industry sectors, and the isolation of enterprises and entrepreneurial activity, conditions that create rivalry and constrict enterprise development [especially SMEs] and place the economy on a *survival* mode. Segmentation within industry sectors results in deficient networks for pooling trade "intelligence" with the consequent detriment to effective

capital utilization²⁵. The massive capital reserves that are concentrated in the surge of trade information, and the synergistic [vibrant] energy inherent in the *cluster culture*, are not perceived for both their economic [and social] value²⁶ by entrepreneurial individualists who remain ensconced in their remote plant locations [by the prevailing condition of industry sector disaggregation.]

Reforms on *technical* measures of the economic system can be calibrated. So, taxes are subject to adjustment. Registrations are subject to timeliness²⁷. Inspections are subject to frequency. Working capital is subject to interest rates. Investment capital is subject to rates of return. Regulations are subject to penalties²⁸. Trade is subject to tariff rates. However, manipulation of these technical measures of the economic system are insufficient actions *per se* to accelerate the stalled the economy. The present disorganization of industry sector trade, and the lack of cohesiveness among enterprises in related industry sectors, sap the energizing potential from reforms on technical measures. Strides, not steps, are essential to achieve momentum for economic progress in decelerating the course toward social instability. Strides require more so conceptual, and behavioral, adjustments in the arrangement, and relation, of economic institutions and their chiefs²⁹.

²⁵ The Microeconomic Competitiveness Index (MICI) rankings for fifty-two nations placed Ukraine in the last position in both 1997 and 1998, this despite the fact that Ukraine foreign direct investment [FDI] inflows were at 3.4 per cent and were exceeded only by Russia among the CIS; and, by only Poland, Hungary, Czech and Romania among Central/Eastern Europe and Baltic states. Source: EBRD.

²⁶ The "cluster culture" has the beneficial side effect of restoring community-oriented social patterns and displacing the anonymous nomenclature of the solicitous State.

²⁷ Decree of Cabinet of Ministries No. 740 on simplified registration procedures for enterprises have been adopted.

²⁸ Decree of the President of Ukraine No. 817, 17 July 1998, was adopted: "On some actions for business deregulation". The Decree regulates the rights and duties of administrative bodies.

²⁹ Economic reforms must include spheres for both *economic*, and *psychological*, transformation. Enterprises must come to integrate sustainable *cooperative behavior* into their activity. Extending reform to socioeconomic issues that impact on economic performance should be a priority at Oblast, as well as Central, level of government.

The second essay presented a particular form of industry sector arrangement, the cluster pattern, as a conceptual model for intensifying the economic performance of capital through inducing competitiveness, productivity and innovation of enterprises [particularly SMEs]. Furthermore, it is noted that the necessary gravitation of isolated enterprises into mutually interdependent networks of production can be facilitated. And attempts to replicate the natural process of cluster patterning should stem from a core of organically-linked socioeconomic region resources that stimulate and support inter-firm collaboration. As such the propagation of clusters arise from a hybrid form of private sector association. The potency from a transition to the industry sector cluster pattern of industrial output, and especially for its potential of increasing the contribution of the SME sector in economic vitality, is said to deserve attention in the formulation of State economic policy.

This, the third essay, suggests a means for reconciling the divisive disturbances in socioeconomic institutional arrangements.

At the outset it must be acknowledged that the relations between government regulatory authorities, and associations of private business leaders, even in advanced economies is not without its strains and awkward accommodations. In each national economy forms of accommodation emerge. In certain Asian countries [such as Japan and Korea] the Government Institutions, Financial Institutions and Industry have traditionally been a *triumverate* in the propagation of trade and the organization of economic activity. On the European continent the association among these representative interests has taken the form of a certain solicitousness/coziness manifest in Government *protection* of the dominant industrial dynasties on its soil. On the North American continent the institutional strains are quenched by a belief that entrepreneurial activities are linked to democratic values. There prevails a certain pro-business climate³⁰. Mitigating excesses in the public and private sectors are the presence of a multitude of aligned and unaligned

³⁰ The prevalence of a pro-business climate does not mean that in the U.S. harmony always prevails. For instance, in Chicago, Illinois, collaboration was, for many years, difficult because business executives and public leaders in that City did not understand or respect one-another. No one believed that a forum existed for sustaining interaction between the public and private sectors.

organizations and associations that monitor the rules and practices and intervene in the conduct of the economy. It is the prevalence, and nature, of these entities and their potential role in the moderation of the socioeconomic environment that we now turn.

Recently transplanted on the Ukraine soil are the saplings of legal entities now common to the North American continent: the not-for-profit organization. This form of legal organization structure has in Ukraine assumed the name: Non-Government Organization or simply NGO. NGOs are a hybrid form of fraternal association. Their existence legally secured. The NGO is granted certain sanctioned privileges and protections. Their magnitude may vary from an entity with only a few employees and a small grant to ones with fifty or more employees and grants exceeding \$100,000. And, like its North American "genus", the NGO may engage in a broad range of activity barred only from direct, profit-making, business activity and from patently political activity³¹. Their global development and role in advocating reforms and moderating excesses in socioeconomic activity, and in furthering the aims of civil society, has received considerable commentary³².

In the United States such organizations are often characterized as *collaborative networks* and share certain common characteristics.

- Foster continuous communication between industry "customers" and "suppliers" in government and the community.
- Serve as neutral forums for raising new ideas for continuously improving the economic vitality and quality of life of the community.

³¹ *Non-Governments: NGOs and the Political Development of the Third World*, Julie Fisher, 1998. The Ukrainian Producers and Consumers League is an example of one such entity primarily concerned with socioeconomic issues. It supports the interest of the Membership through information and advocacy activities.

³² Recently, Klaus Schwab, Director of the World Economic Forum, commented: "Civil society, represented by its own institutions like the NGOs, has become the third leg of our business and government global community." *Newsweek*, February 1, 1999.

- Act as catalysts, and moderators, to create, and provide, support for initiatives for orderly change in economic and civil society.

As such the US genus of the NGO model is one part of the vital linkage among networks of business, government and community leaders. These networks are based on voluntary *commitments to shared interests*. Their mission: to bring together people from business, government, education, and the community to act on regional issues affecting economic vitality and quality of life.

In Ukraine the advance of NGO involvement in the economic and civil sectors of society is rooting. It is estimated that 200 or so such entities are registered and function. The nature of their activity varies. Often they are single purpose organizations devoted to a particular cause³³.

The most common aims for NGOs are civil sector services and advocacy³⁴. Larger, multipurpose, NGOs are very visible in the economic sector. These offer a variety of services for their Members [e.g., management training] and act as advocates for legislative reforms [e.g., relief from excessive regulatory requirements]³⁵. Also visible in the economic sector are business services organizations whose functions are to provide specialized technical assistance [TA] [e.g., financial, accounting, legal, technical commercial]³⁶. There thus is underway a proliferating transformation of the former monolithic socioeconomic and civil society structure.

The economically least-developed countries have demonstrated an inability to create national and regional structures for converging the economic and social interests of the public and private institution domains. This phenomenon is evident in present-day Ukraine³⁷. By placing most of the

³³ Ukrainian National Association of Savings and Credit Union.

³⁴ A NGO implementing a child abuse prevention program is an example of a single purpose organization in the civil sector.

³⁵ Ukrainian Entrepreneurs Union of Small, Medium and Privatized Enterprises.

³⁶ Institute for International Business Development.

³⁷ Ukraine, unlike its neighbor Russia, has less manifest indigenous cultural traits that have been congealed by its *literati* into a certain sense of destiny for potentially higher forms of modernity. Those interested in this subject are referred to: *The Russian Idea and Its Creators*, ed., Arsenii Gulyga.

blame for current economic ills on the Central Government, business interests have underestimated the weakness of their own productive capability in the face of radical changes in the nature of their markets. Confused, and unable to respond to change effectively, the business sector frustrates the State with [circumvention], a behavior pattern that ultimately alienates the shared interest of both sectors in a productive society. The State faced with the crisis of unemployment, deterioration of capital assets, declining GDP, and potential insolvency –and incapable of responding effectively–frustrates the business sector with its own obstinate technical counter measures.

Required is the generation of an energy for change in behavior and attitude that brings about the necessary convergence of interest toward a dynamic economy. It is into this breach of confidence, and trust, between the public and private sectors shared interests in economic and civil order that the mounting legions of NGOs perform their reconciliation functions. In those underdeveloped economies where the diverse initiatives of NGOs have been particularly resourceful in facilitating socioeconomic and civil society transformations there is visible an abating of the frustrating antagonisms that yield to retaliatory economic counter measures.

A Prototype: The Podillya Pershyi NGO

The Podillya Pershyi NGO was established to implement a three Oblast *regional redevelopment program*³⁸. Its creation was in recourse to the absence of a suitable institutional structure³⁹ within the Khmelnytskyi Oblast Administration for initiating economic reforms and economic transformation⁴⁰. Moreover,

³⁸ The redevelopment activities of the Podillya Pershyi Program [PPP] embrace: Khmelnytskyi, Vinitza and Ternopil Oblasts.

³⁹ Initially an attempt was made to raise the program in the Oblast Department of Economy. It soon became apparent that the concepts, particularly the cluster strategy, appeared too foreign for the professional staff and officials. The Department had had experience with a *business center* and could not see beyond that center's TA attempts with TA[mostly writing business plans and arranging some counseling] for Oblast action in improving business conditions.

⁴⁰ Attempts to initiate a regional redevelopment program under the former Oblast Administration encountered staff responses ranging from indifference to opposition. The present Administration fully supports the PPP. The Administration has recently officially

the Oblast did not possess the scientific, technological and organizational base, or even the educational and cultural base, to enable it to set the innovation process in motion.

Creation of the NGO had necessitated some special considerations. Its proposed ambitious activities would, eventually, extend well beyond the range of the more typical NGO organizations. Its aim would be to restore the economic vitality of the Podillya region. The order of its priorities would be: (1) to save present jobs; (2) preserve potentially valuable assets; and (3) assist in the creation of new enterprises [primarily SMEs]. Moreover, implementation of the Program's cluster strategy would immerse the NGO directly in all aspects of stimulating *business* activity. Not only would technical assistance be offered, but there could also be direct participation in discussions on business opportunities, rearranging the configuration of production among firms in the cluster, initiating the development of a *standard of quality* trade mark, creation of product innovation. In other words, the NGO would not confine business development technical assistance to individual enterprises seeking to exploit some natural, or artificial advantage; indeed it would *avoid* business development activities which are independent and forgo the beneficial linkages that operate among different cluster participants.

In other words, the NGO would be an active *change-agent*. It seeks decisive adjustments in policy for support of development, that is the reconciliation of both behavioral and technical measures (whose origins are public, public-private, private national or international) with the aim of spurring the development of production activity. Enterprises would be gathered into an arrangement of networks viz., clusters, within which each would shape its strategy within a network of relationships of a relatively complex and lasting nature. Success would depend on the intensity of the relationship. Such relationships would have to be *constructed* and would not be constrained by an *external environment* that could be hostile to the autonomous firm. It is within such structures [viz., clusters] that one commences on the objective of transforming dysfunctional behavior among industry sector enterprises; and, of the corresponding external task of *negotiating* with community institutions first a *modus vivendi* and, ultimately, a *modus operandi*.

included the Program among its proposed 1999 initiatives in its submittal to the Oblast economic development plan.

The emergence of the NGO institutional structure in Ukraine arrived at a critical juncture in the upheaval of Ukraine's socioeconomic condition. The NGO represents a moderating and reconciling force to further aggravating the course toward divergence between government and industry interests. The NGO is also a potent force for initiating regional economic redevelopment. NGO intervention in the organization of industry sector clusters has the potential for reconciling the mistrust that commonly exists among competing firms. And only through such cooperation and collaboration can successive improvements in business conditions be achieved. Critical for Ukraine industry is product innovation. [Without innovation there is limited opportunity for export and access to hard currency.] This particularly justifies the abandonment of prevailing strategies of product imitation alone, in favor of more dynamic and complex strategies of imitation-improvement-transformation. The NGO, acting as a stimulus in the reformation of enterprise *status quo* behavior, presents a vital new component in Ukraine's economic resurgence.

The Podillya Pershyi NGO has a complex structure reflecting its comprehensive approach to redevelopment activity. The Organization supports seven initiatives:

- **THE ORGANIZATION OF INDUSTRY SECTORS INTO CLUSTERS.** Initially three industry sectors have been selected for clustering: apparel fashion industry; food processing industry; and building materials industry.
- **DEVELOPMENT OF NEW, HIGH VALUE-ADDED, PRODUCTS THAT CAN BECOME COMPETITIVE IN GLOBAL MARKETS.** Production for domestic consumption is supported only where value-added output is not based exclusively on low wages for competitiveness⁴¹.
- **DEVELOPMENT OF NETWORKS WITH VENDORS AND BUYERS** who are expected to participate in advancing the state of competitiveness, productivity and innovation⁴².

⁴¹ Several such new products are now in the prototype phase of development.

⁴² For instance, students from the Technological University of Podillya are enlisted to assist in the redesign and restyling of apparel fashions produced by cluster enterprises.

- **DEVELOPMENT OF NETWORKS WITH REGIONAL PUBLIC AND PRIVATE INSTITUTIONS** whose services can impact on the results of cluster performance.
- **DEVELOPMENT OF BI-LATERAL ARRANGEMENTS WITH PUBLIC AND PRIVATE INSTITUTIONS OUTSIDE THE REGION, AND OUTSIDE THE COUNTRY**, where beneficial arrangements can be negotiated⁴³.
- **DEVELOPMENT OF COOPERATIVE RELATIONS WITH THE REGION'S VARIED TECHNICAL ASSISTANCE [TA] SERVICES PROVIDERS**⁴⁴. The NGO interfaces with the World Bank, in its implementation of the Public Sector Development Program [PSD]⁴⁵. The NGO interfaces with TACIS in the implementation of its management retraining program for military officers for placement in cluster enterprises.
- **DEVELOPMENT OF COOPERATIVE RELATIONS WITH LOCAL GOVERNMENT** in seeking improvement of the business climate for enterprises [particularly SMEs]⁴⁶.

Each of these initiatives is in its infancy. The NGO exists now not quite one year. Yet in this brief period considerable progress has been made on each of the seven initiatives.

Perhaps most notable is the present state of development of the first totally new product for penetration in the global fashion market. Its market potential is sufficient to restore employment in the region's light industry sector. Considerable work remains to be done to bring the product from prototype to limited production for market testing. Clearly, present customer enthusiasm and satisfaction with the product cannot totally ensure the cooperating

⁴³ For instance, a contact was established with the Poland Center of Fashions, Lodz. Arrangements were made for presenting Podillya-made fashions at shows for buyers sponsored by the Center. The Center has also agreed to assist in the development of a Fashion Center for Podillya.

⁴⁴ For instance, the NGO has its offices in the Business Incubator located on the grounds of the Technological University.

⁴⁵ The NGO staff drafted the winning proposal selected by the World Bank for implementation.

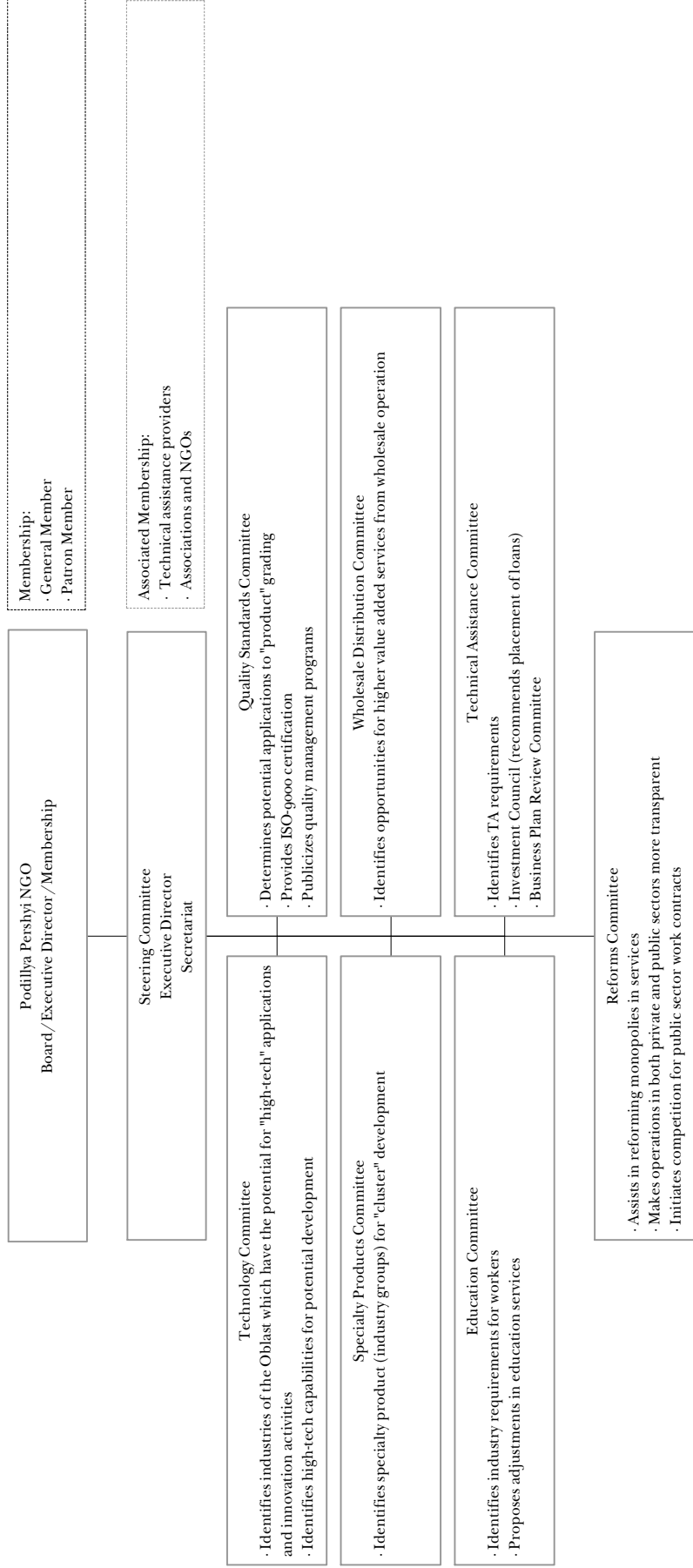
⁴⁶ For instance, the NGO has encouraged the Oblast and the City Administrations to initiate dialog with Directors of local SMEs to identify measures that can be initiated to relieve enterprises from excessively burdensome regulatory and licensing requirements.

participants from disappointment. Yet one important point for the future redevelopment of the local economy is coming to be appreciated. Namely, impetus for product innovation is more favorable within a process of cooperation and collaboration (than in isolation). Numerous participants from the public and private sectors so far have volunteered their services in this effort on a speculative basis. The potency of sustainable relations among enterprises in the same industry sector is becoming manifest. The project remains to demonstrate the potency from *convergence* of government and business interests.

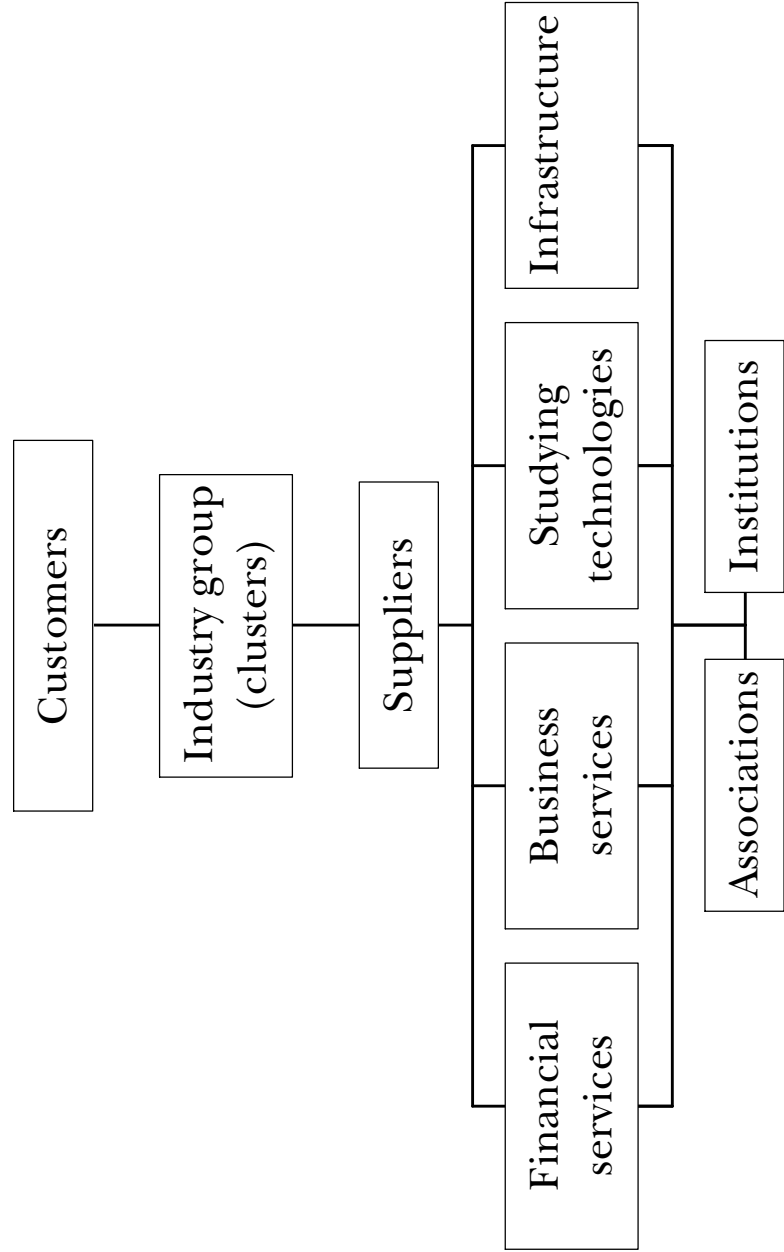
So far there is presented the *economic* aspects of the socioeconomic transformation that the Program propagates. Yet there emanate from the various Program initiatives a certain orientation toward community values. Podillya Pershyi vitalizes the virtues of common sense, personal responsibility and discretion in the weighing of choices as counters to dead-end existence from economic and social breakdown. There is fostered an ethic of achievement, of civic culture and of universalistic social patterning. This patterning process stems from no attempts at indoctrination. Rather it emerges naturally from the interaction of day-to-day program activities. The suffusion of the socioeconomic patterning is, generally, not perceived...but is not unnoticed⁴⁷. Elements for a public ethic, and for personal virtues, are at the core of all the NGO's regional economic development activity. The elements are penetrating the society of the region, working their way into the consciousness of community institutions and the body politic.

⁴⁷ When perceived, the effects from the "cluster culture" are derided, by some, as irrelevant or as inadequate for the serious conditions that prevail...or even mocked for their *western* origin. And in a few instances the Program has had to face countermeasures. Yet on the whole the Program's pattern for regional economic redevelopment commands a skeptical respect. ["Moshlivo" is the most frequent voiced response to any assessment of the effects from Program initiatives.]

Podillya Pershyi NGO



Cluster system



Podillya Pershyi Program

